United Nations A/72/795–S/2018/226

General Assembly
Security Council

Distr.: General
20 March 2018

Original: English

General Assembly
Seventy-second session
Agenda item 34 (a)
Prevention of armed conflict

Security Council
Seventy-third year

Letter dated 6 March 2018 from the Permanent Representative of Ukraine to the United Nations addressed to the Secretary-General

On 1 March 2018, PJSC Gazprom (Russian Federation) refused to supply already prepaid gas volumes to Ukraine. The situation resulted in additional load on the Ukrainian gas transmission system and created significant technical risk for its operation. Moreover, on 2 March 2018, PJSC Gazprom announced its decision to withdraw from the contracts signed in 2009.

It is clear that Gazprom is again using gas as a political tool aimed at undermining the security of the gas supply to Europe, which is especially cynical at the current time of low temperatures in Ukraine and across the European Union.

This is also a clear abuse of Gazprom's dominant market position.

In view of the above, Ukraine has requested the European Commission to facilitate immediate trilateral consultations in Ukraine-European Union-Russia format and to trigger the early warning mechanism as provided for under article 340 of the Ukraine-European Union Association Agreement.

The Ukrainian Government will do its utmost to implement the valid contractual obligations and decisions by the Tribunal in good faith.

The Ukrainian side will also use all available tools and remedies to make Gazprom respect its legal obligations and compensate for the damage caused by this violation.

Such a step proves the need to assess the real goals of the Nord Stream 2 and similar projects and to take all necessary measures, at the national and multinational, commercial, governmental, legislative and political levels, to prevent such situations from recurring in the future.

More detailed information on the development of the situation is attached (see annex).

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Please recycle

I would appreciate your kind assistance in having the present letter and its annex distributed as a document of the General Assembly, under agenda item 34 (a), and of the Security Council.

(*Signed*) Volodymyr **Yelchenko**
Ambassador
Permanent Representative

Annex to the letter dated 6 March 2018 from the Permanent Representative of Ukraine to the United Nations addressed to the Secretary-General

2 March 2018

Situation with gas supplies and transit

Background

There are two contracts signed between Naftogaz and Gazprom in 2009: one covers gas shipments to Naftogaz and the other covers gas transit from Russia to the European Union and Moldova via Ukraine.

The contracts were signed amidst the 2009 gas crisis, when Russia stopped supplies to both Ukraine and the European Union because of contractual disagreements.

Gazprom had the upper hand in the crisis, using gas supply interruption in the middle of a cold spell to exert pressure on both Ukraine and its Western partners.

As a result, the contracts were vague and contained certain ambiguous provisions, which Gazprom used to discriminate against Naftogaz by charging prices way above the market rate and requiring the company to pay for excessive volumes of gas, even if they were not off-taken.

Before 2014 the Ukrainian Government had to ask for arbitrary discounts from the Russian Government in order to get discounts and waivers on the obligation to buy unnecessary gas volumes. These discounts were used to force certain political concessions from Ukraine.

In 2014, the parties initiated arbitration proceedings on the two contracts. The final decision on the supply contract was awarded on 22 December 2017 and on the transit contract in February 2018.

The value of the total claims in these two arbitrations makes the dispute the biggest commercial arbitration in history and consists altogether of $125 billion when the total claims and counterclaims are summarized.

Both contracts are valid until the end of 2019.

Stockholm arbitration of 22 December 2017

On 22 December 2017, the Stockholm Tribunal made a decision on the supply contract between Naftogaz and Gazprom.

- The decision inter alia dismissed all claims from Gazprom to Naftogaz to pay for gas which was not ordered by Naftogaz ("take-or-pay" principle). The claim value under the take-or-pay provision of the contract amounted to $56 billion by the end of 2017.
- For 2018 and 2019, the Tribunal granted Naftogaz's request to reduce the minimum contract volume by nearly 10 times, to 4 billion m^3 of gas per year.
- The total contract volume was decreased from 52 billion m^3 to 5 billion m^3 per year.
- Therefore, following the award, Naftogaz is obliged to buy a minimum of 4 billion m^3 of gas from Gazprom per year, and Gazprom is obliged to sell up to 5 billion m^3 of gas upon request by Naftogaz.

- The old gas pricing formula, pegged to the price of oil products, was replaced with the relevant price of a specific gas contract on the German NCG hub (Ukraine's nearest liquid hub).
- Naftogaz and Gazprom had a series of meetings to agree on the practical steps to implement the award in January and February 2018.

Stockholm arbitration of 28 February

Background

On 28 February the Stockholm Arbitral Tribunal ruled in favour of Naftogaz in the dispute with Gazprom regarding the gas transit contract of 2009.

The Tribunal found that Gazprom had defaulted on its obligations regarding volumes to be transited and awarded damages of $4.63 billion.

The award means that Gazprom will have to pay Naftogaz $2.56 billion after residual payments for gas delivered by Gazprom and not fully paid by Naftogaz have been offset and fully settled.

The decision has an immediate effect. Interest of approximately $0.5 million accrues daily on the amount currently outstanding.

The agreed volume to be transited covers a significant share of European gas demand. The contract is consequently of great importance to European buyers and consumers. Naftogaz expects that transit to Europe will continue as before.

The Tribunal did not grant Naftogaz's claim for revision of the transit tariff, because Naftogaz's 2009 request for revision did not fulfil the procedural requirements.

The Tribunal also did not accept Naftogaz's claims for revision of the transit contract based on European and Ukrainian energy and competition law, noting that the implementation of regulatory reform on Ukrainian territory is a task for the Ukrainian authorities, going beyond the Tribunal's powers in this case.

Therefore the transit contract will now need to be revised, taking into account the award and the requirements of European and Ukrainian law.

Gazprom's failure to supply gas

The tribunal award of 22 December 2017 is sufficient for the changes to take effect. However, the parties discussed the idea of signing an addendum to the supply contract to make sure that both parties are clear on how specifically the 800-page award is to be implemented in the contract.

During negotiations on the new addendum which took place in January and February 2018, Gazprom, in front of many witnesses, repeatedly insisted that an addendum would be only a matter of convenience and that they would be ready to supply gas on the basis of the Tribunal decision, with the only condition that Naftogaz prepay an invoice issued by Gazprom.

Naftogaz signed a draft addendum reflecting the agreed position and sent it to Gazprom in the middle of February 2018.

During the week of 26 February, Gazprom refused to sign the addendum, stating that an addendum was not necessary for the implementation of the contract.

On 26 February, Gazprom issued an invoice for gas to be supplied in March. The terms were reflective of the Tribunal's decision both on the volumes and the pricing.

On 26 February, Naftogaz made a prepayment of $127 million against this invoice, expecting the delivery of approximately 0.5 billion m^3 during March (nearly 18 million m^3 per day, starting from 1 March).

Gazprom has confirmed receipt of the prepayment.

On 28 February, Gazprom delayed sending a standard nominations request to Ukrtransgaz. This request is the basic means for the two parties to agree their actions on a daily basis.

Meanwhile, Gazprom's employees were not taking calls or answering messages (neither the management nor the technical staff).

The nominations request as finally received by Ukrtransgaz did not contain the volumes ordered by Naftogaz.

On the morning of 1 March, minutes before the supplies should have begun at 10 a.m., Gazprom informed Naftogaz that it would not supply gas and would proceed with refunding the prepayment.

Gazprom indicated the absence of the signed addendum as a reason for such a decision.

Naftogaz has been surprised to learn of Gazprom's decision not to supply gas to Ukraine in March.

The company regards Gazprom's refusal to supply gas as a contractual violation and non-compliance with the Tribunal's award.

Naftogaz will demand that Gazprom provides compensation for the damage caused by this violation.

By refusing to supply this prepaid gas, Gazprom prevents Naftogaz from fulfilling the award regarding the purchase of minimum contract volumes.

Over the past four years of gas purchases from European suppliers, Naftogaz has never encountered a comparable situation, where the company would not receive prepaid fuel.

On 2 March 2018, Gazprom CEO announced Gazprom's withdrawal from the contract with Naftogaz. The statement is being assessed by the legal team.

Ukraine's security of supply measures

Following the abrupt failure of Gazprom to supply gas on 1 March, Naftogaz and the Ukrainian authorities were confronted with a crisis situation and have been implementing a number of steps.

The total daily demand in Ukraine currently stands at approximately 200 million m^3.

Of this demand, the majority (over 100 million m^3) is covered by gas withdrawn from the underground storage, which is being operated near to maximum capacity, given the current balance of stored gas.

Nearly a third of the daily demand is covered by the local gas production.

Naftogaz and other companies are importing gas from the European Union to balance the gas needs.

On 1 March, Naftogaz had to urgently find and contract approximately 18 million m^3 of gas per day to replace the volumes expected from Gazprom.

Given Gazprom's last-minute refusal to supply prepaid gas and the fact that it has announced this decision publicly, Naftogaz faced a sharp hike in prices.

The current cold spell in both Ukraine and the European Union makes gas supplies in the coming few days extremely scarce, which has an aggravating effect on the cost of the available gas.

Naftogaz will seek compensation from Gazprom for the damages it has incurred when contracting gas in an emergency mode.

Ukraine has introduced the plan of extraordinary Security of Supply measures developed jointly with the US government experts in 2015.

The plan involves industrial consumers, the public sector and heat producers and is aimed at reducing the daily gas demand.

The extraordinary measures include:

- Decreasing temperature regimes
- Shifting to alternative fuels
- Temporarily closing certain public facilities (schools, kindergartens, etc.)

On request of the Ukrainian authorities, Naftogaz has addressed the public with a request to voluntarily lower the temperature in their homes by 1–2 degrees Celsius during the coming three days to ensure resilience against any further potential misconduct from Gazprom.

Given the emergency of the situation, Naftogaz and Poland's PGNiG have signed a contract for urgent gas supplies. The contract with PGNiG is effective until the end of March 2018. The contracted volume totals over 60 million m^3. The delivery started on 2 March 2018 at 6 a.m., through the Hermanowice node, which connects Polish and Ukrainian gas transmission systems.

Gas deliveries from Poland will allow the extraordinary measures to be lifted in the very near future.

The Ukrainian side informed the European Commission of the situation already on the afternoon of 1 March 2018.

On the evening of 1 March 2018, Ukraine requested the European Commission:

- To facilitate immediate trilateral consultations in Ukraine-European Union-Russia format
- To trigger the early warning mechanism as foreseen by article 340 of the Ukraine-European Union Association Agreement

The Ukrainian Government and Naftogaz will do their utmost to implement the current contracts and decisions by the Tribunal in good faith.

Ukraine is and will remain a reliable energy partner for Europe.